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By GAURAV JAINN

FCA, CFA L3 Candidate

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Shreshta Tayal
AIR 20
Roll No. 141557
68 Marks
(AIR/CA/CS 20th)
May 2015
1
ALL INDIA RANK
Shailee Chaudhary
AIR 1
Roll No. 130814
88 Marks
Nov. 2014
Anish Gupta
AIR 22
Roll No. 188172
68 Marks
Nov. 2015
Payal Bansal
AIR 27
Roll No. 137808
70 Marks
May 2014
Pravesh Khandelwal
AI 2nd Highest
Roll No. 125761
85 Marks
May 2017
Naman Jain
Roll No. 133759
94 Marks
Nov. 2014
Keshav Goel
AIR 18
Roll No. 132485
83 Marks
Nov. 2013
Nishant Gupta
AIR 17
Roll No. 162871
77 Marks
May 2016
Harsh Garg
AIR 17
Roll No. 408489
74 Marks
May 2016
Kunal Somani
AIR 14
Roll No. 438272
88 Marks
May 2016
Prashu Goyal
AIR 36
Roll No. 480693
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Scoring 73 Marks in SFM
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Sejal Goel
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Manish Wahi
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Pooja Gupta
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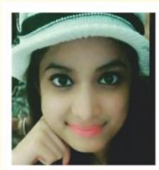

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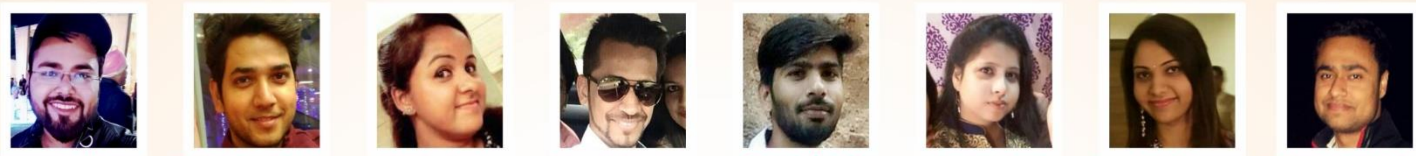

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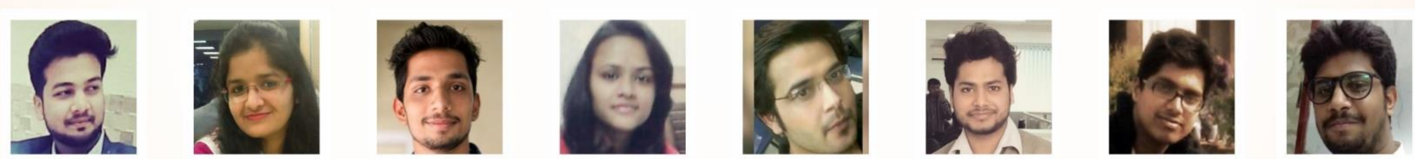

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Tanveer Akhtar
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Prateek Joshi
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Pallavi Singhal
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Gaurav Chauhan
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Anu Jain
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Yashank Garg
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Mohit Singh
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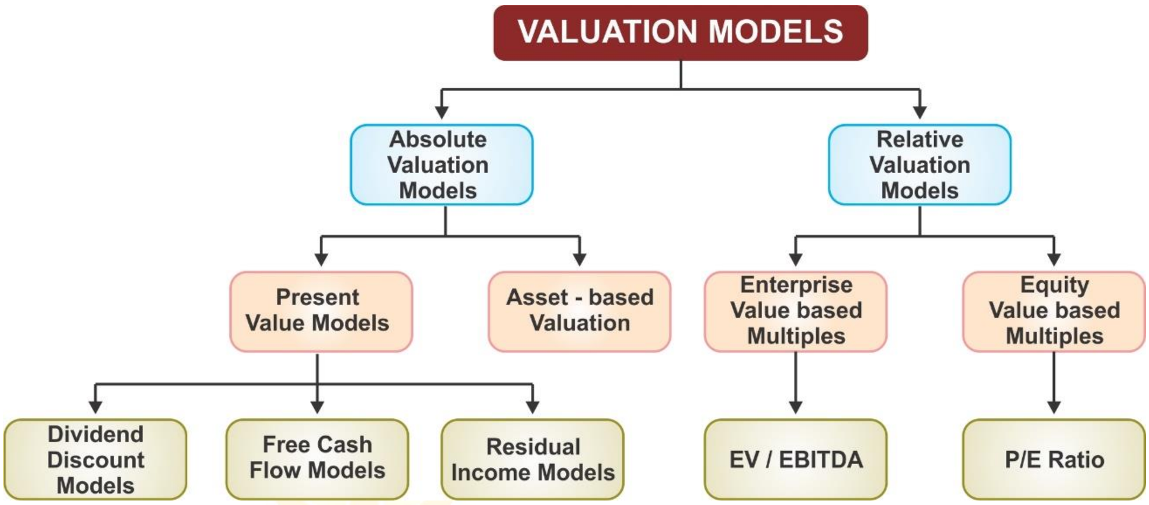
Corporate Valuation

Study Session 3

LOS 1 : Introduction



LOS 2 : Dividend Yield Valuation Method

$$\text{Dividend Yield} = \frac{\text{DPS}}{\text{MPS}}$$

$$\boxed{\text{MPS} = \frac{\text{DPS}}{\text{Dividend Yield}}}$$

Note:

$$\text{DPS} = \frac{\text{Total dividend paid}}{\text{Total number of equity shares}}$$

Total Market Value = MPS × Total Number of Equity share

LOS 3 : Earning Yield Valuation Method

$$\boxed{\text{Earning Yield} = \frac{\text{EPS}}{\text{MPS}}}$$

$$\text{MPS} = \frac{\text{EPS}}{\text{Earning Yield}}$$

$$\text{Therefore, EPS} = \frac{\text{Earning available to Equity Share holders}}{\text{Total number of equity shares}}$$

LOS 4 : P/E Ratio Valuation Model

$$\text{P / E Ratio} = \frac{\text{MPS}}{\text{EPS}}$$

$$\boxed{\text{MPS} = \text{EPS} \times \text{P/E Ratio}}$$

LOS 5 : Value Based on Future Maintainable Profits (FMP's)

$$\text{Value of Business} = \frac{\text{Future Maintainable Profit}}{\text{Relevant Capitalisation Rate}}$$

Value of Business – Market Value of Debt = Value of Equity

Calculation of Future Maintainable Profits:

Average Past Year Profits before tax	xxx
Add : All Profit likely to arise in Future	xxx
All Actual Expenses & Losses not likely to occur in future	xxx
Less : All Profit not likely to occur in Future	xxx
All Actual Expenses & Losses likely to occur in future	xxx
Future Maintainable Profits (FMP's) before tax	xxx
Less : Tax	xxx
FMP's after tax	**xxx**

Note:

Treatment of Sunk Cost

Sunk Cost are those cost which are not relevant for decision making. These cost must be totally ignored. Example: Allocated Fixed Cost, R & D cost already incurred.

LOS 6 : Net Asset Valuation Method (For Equity)

$$\text{NAV per Share} = \frac{\text{Total Assets} - \text{Total External Liability}}{\text{Total number of equity shares}}$$

Note:

1. **The following external liabilities should be deducted**

- ❖ All short term (Current Liabilities) and Long Term Liabilities (Debenture, Loans, etc) including outstanding and accrued interest.
- ❖ Provision for Taxation
- ❖ Liabilities not provided for in the accounts i.e. Contingent Liabilities which have crystallized now.
- ❖ Liabilities arising out of prior period adjustment
- ❖ Preference Share Capital including Arrears of dividend and proposed preferred Dividend
- ❖ Proposed Equity Dividend (If the objective is to determine ex-dividend value of equity share).

2. Total assets doesn't include Miscellaneous Expenditure to the extend not yet written-off, fictitious assets, accumulated losses, profit & Loss (Dr.) Balance.
3. **NAV may be calculated by using**
   a) **Book Value (BV):** The BV of an asset is an accounting concept based on the historical data given in the balance sheet of the firm.
   b) **Market Value (MV):** The MV of an asset is defined as the price which is prevailing on the market.
   c) **Liquidating Value (LV):** The LV refers to the net difference between the realizable value of all assets and the sum total of external liabilities. This net difference belongs to the owners/ shareholders and is known as LV.
4. **If question is silent always prefer Market Value weights.**

LOS 7 : Economic Value Added (EVA)

It is excess return over minimum return which is expected by the company on its Capital employed.

$$\boxed{\textbf{EVA = NOPAT} - K_0 \times \textbf{Average Capital Invested}}$$

Calculation of NOPAT:

❖ NOPAT means, **N**et **O**perating **P**rofit **A**fter **T**ax but before any distribution of Interest, Preference Dividend and Equity Dividend.

i.e. NOPAT = EBIT (1 – Tax Rate)

Note: It excludes non-operating income & expenses/losses like

❖ Profit/Loss on Sale of Fixed Assets
❖ Interest on non-trade investment
❖ Profit/Loss on trading in shares & bonds
❖ Interest income from Loans & Advances

Calculation of Cost of Overall Capital:

K_0 = Cost of Overall Capital = WACC = **W**eighted **A**verage **C**ost of **C**apital

$K_e W_e + K_r W_r + K_D W_D + K_P W_P$

Note:

1. K_d = Interest (1- Tax Rate)
2. $K_e = R_f + \beta (R_m - R_f)$ Or $K_e = \frac{D_1}{P_0} + g$
3. K_p = Preference Dividend (1 + CDT)
4. Calculation of Average Capital Invested:

$$\frac{\textbf{Capital at the beginning + Capital at the End of Year}}{\textbf{2}}$$

5. Calculation of Capital Invested:

	Equity share capital
Add	Preference share capital
	Reserve & Surplus
	Debenture/Bonds
	Long-Term Loan
Less	P/L (Dr. Balance)
	Preliminary Expenses
	Miscellaneous Expenditure

Note: It excludes:

- ❖ Investment in Equity shares & Bonds
- ❖ Loans & Advances
- ❖ Non-Trade Investment

6. Financial Leverage $= \frac{\textbf{EBIT}}{\textbf{EBT}}$ **Or** $= \frac{\textbf{EBIT}}{\textbf{EBIT}-\textbf{Interest}}$

7. EBIT = EBT + Interest

EBIT = $\frac{PAT}{(1-tax\ rate)}$ + Interest

EBIT = $\frac{Earning\ for\ equity+Pref\ Div}{(1-tax\ rate)}$ + Interest

8. **Note :**

- ❖ Operating profits may have to be adjusted using matching concept.
- ❖ There might be some intangible assets such as patents, trademark etc. which is not shown in balance sheet, we need to include that in invested capital.
- ❖ The balance sheet figures of assets & liabilities are at book value. If replacement cost is provided, take invested capital at replacement cost instead of Book Value.

LOS 8 : Value of Business using EVA Method

Valuation of Business using EVA Method (Assume Constant growth after 2 years):

$$\textbf{MVA} = \frac{EVA_1}{(1+K_0)^1} + \frac{EVA_2}{(1+K_0)^2} + \frac{\frac{EVA_2\,(1+g)}{K_0 - g}}{(1+K_0)^2}$$

MVA = Value of Business – Total Capital Employed

Value of Business = Total Capital Employed + MVA

LOS 9 : Discounted Cash Flow approach or Free Cash Flow Approach or Value of Business using FCFE & FCFF

Under this approach, we will calculate value of business by discounting the future cash flows.

Steps Involved:

Step 1: Calculation of Free Cash Flow of each Year.
Step 2: Calculate Terminal Value at the end of forecast period.
Step 3: Compute Discount Rate
Step 4: Calculate Present Value of Business/ Equity by discounting the Cash Flows & Terminal Value.

Calculation of Terminal Value / Continuing Value / Salvage Value

Terminal Value is calculated at the end of the Project Life or at the end of the forecasted period.

Note:

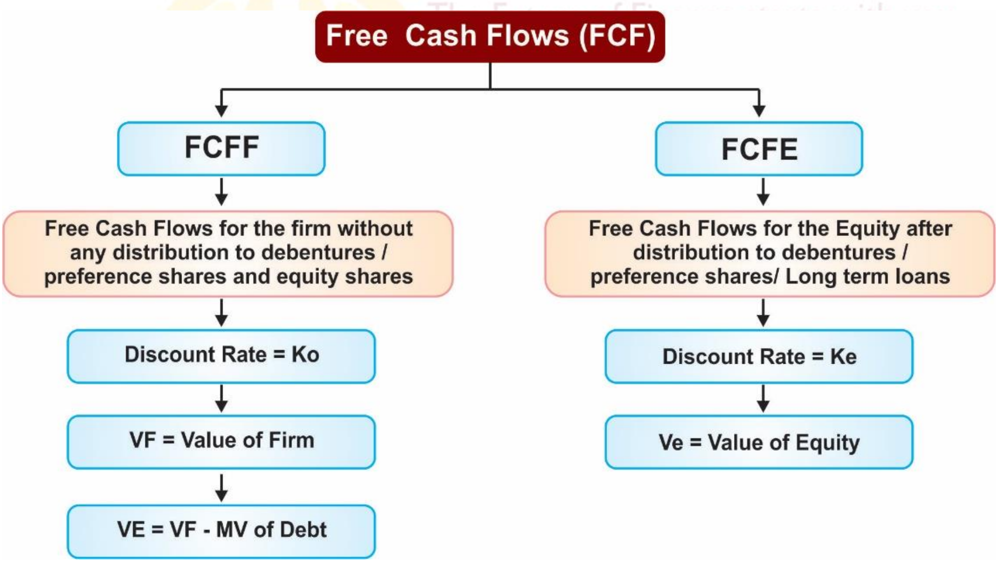
- **Given in the Question.**
- **Assumption of Growth Model (Let's assume Growing Cash Flow after 3 Years)**

$$P_0 = \frac{CF_1}{(1+K_0)^1} + \frac{CF_2}{(1+K_0)^2} + \frac{CF_3}{(1+K_0)^3} + \frac{\left[\frac{CF_3\,(1+g)}{K_0 - g}\right]}{(1+K_0)^3}$$

- **Assumption of Constant Model/ Perpetuity Approach (Let's assume Constant Cash Flow after 3 Years)**

$$P_0 = \frac{CF_1}{(1+K_0)^1} + \frac{CF_2}{(1+K_0)^2} + \frac{CF_3}{(1+K_0)^3} + \frac{\left[\frac{CF_3}{K_0}\right]}{(1+K_0)^3}$$

- Continuing value/ Terminal Value is calculated because it is not easy to estimate realistic cash flows, so we take uniform assumption of Constant Model or Growth Model.



Calculation of FCFF

EBITDA	xxx
Less : Depreciation(NCC)	xxx
EBT	xxx
Less : Tax	xxx
NOPAT	xxx

Add : Depreciation (NCC) Less : Increase in Working Capital (WCInv) Less : Capital Expenditure (FCInv)	xxx xxx xxx
Free Cash Flow For Firm (FCFF)	**xxx**

Calculation of FCFE

Method 1 : When Debt-financing ratio is given:

EBITDA Less : Depreciation & Amortisation EBIT Less : Interest EBT Less : Tax PAT Add : Depreciation × % Equity Invested Less: Increase in Working Capital × % Equity Invested Less: Capital Expenditure × % Equity Invested	xxx xxx xxx xxx xxx xxx xxx xxx xxx xxx
Free Cash Flow for Equity (FCFE)	**xxx**

Calculation of FCFE

Method 2 : When Debt-financing ratio is not given:

EBITDA Less : Depreciation & Amortisation EBIT Less : Interest EBT Less : Tax PAT Add : Depreciation (NCC) Less: Increase in Working Capital (WCInv) Less: Capital Expenditure (FCInv) Add : Net Borrowings	xxx xxx xxx xxx xxx xxx xxx xxx xxx xxx xxx
Free Cash Flow for Equity (FCFE)	**xxx**

LOS 10 : Calculation of Range of Valuation

The range of valuation means we have to calculate minimum & maximum value of business by using more than one method as indicated in question.

LOS 11 : Valuation with NPV decision

$$\text{Revised MPS} = \text{Existing MPS} \pm \frac{\textbf{Total NPV}}{\textbf{Total number of Equity Shares}}$$

LOS 12 : Market Value Added (MVA)

From Equity Point of View

$$\text{MVA} = \left[\begin{matrix}\text{Value of Equity} \\ \text{as per market}\end{matrix} - \begin{matrix}\text{Value of the Equity} \\ \text{as per Books of A/c's}\end{matrix}\right] \text{for equity shareholders}$$

= MPS × No. of Equity share – Equity Shareholder's Fund.

Note:

	Equity share capital
Add	Reserve & Surplus
Less	P/L (Dr. Balance)
	Preliminary Expenses
	Miscellaneous Expenditure

From Overall company's Point of View

MVA = Value of the company based on Free Cash Flows – Total Capital Employed

Note: Total Capital Employed

	Equity share capital
Add	Preference share capital
	Reserve & Surplus
	Debenture/Bonds
	Long-Term Loan
Less	P/L (Dr. Balance)
	Preliminary Expenses
	Miscellaneous Expenditure